FINANCIAL ACCOUNTING

Foundation stage examination
6 June 2000

From 10.00 am to 1.00 pm
plus ten minutes reading time from 9.50 am to 10.00 am.

Instructions to candidates

*Answer **five** questions in total: **All four** questions from Section **A**, and **one** question from Section **B**. The marks available for each question are shown in italics in the right-hand margin.*

All workings should be shown. Where calculations are required using formulae, calculators may be used but steps in the workings must be shown. Calculations with no evidence of this (for example, using the scientific functions of calculators) will receive no credit. Programmable calculators are not permitted in the examinations room.

Formula sheets, statistical tables, graph paper and cash analysis paper are available from the invigilator, where applicable.

SECTION A (Answer all four questions)

1 Fiona the Florist completed her first year of trading to 31 May 2000. Fiona has spent the last twelve months building up her business and has not paid too much attention to the financial side of things. Fiona is aware that she needs to produce something for the taxman regarding her activities during the year and has come to you for help. After a number of conversations with Fiona, and an examination of her records, you establish the following:

In May 1999 Fiona won £8,000 on the National Lottery and, together with a £2,000 loan from a friend, used this to open a business account with Floyds Bank Plc on 1 June 1999. On the same date she also took possession of rented premises. Fiona's first acquisition was a delivery van costing £12,000. Fiona obtained excellent repayment terms from XYZ Motors. She paid a deposit of one third immediately, with the remaining two thirds being due for payment in June 2000, all interest free. The loan from her friend had an interest rate of 10%. From another friend Fiona bought some second hand shelving, a cash till, computer and printer. She thought that for £5,000 the package seemed fair as she felt all would last for at least eight years. And finally, Fiona bought various types of scissors and secateurs for £100 which she felt would be replaced during the year due to wear and tear. After paying for an advertisement for £500 in Red Pages, Fiona was ready for business.

A further analysis of Fiona's bank statements revealed the following additional receipts and payments:

		£
Cash paid in		2,000
Cheques paid in		48,320
Payments for:	Flowers	39,200
	Motor expenses	350
	Insurances	850
	Business rates	950
	General expenses	390
	Rent	5,680
	Advertising	140
	Suniholidays*	870
	Utility expenses	2,090

Fiona acquires all her flowers on credit. To confirm the amount owing you decide to write to all her suppliers. The replies when totaled confirm that creditors amount to £1,250. Fiona only accepts cash and cheques for all sales.

* Payment for a personal holiday.

Expense levels relevant to the shop's trading year were as follows:

	Business Rates	Rent	Insurance
	£	£	£
1 April 1999 - 31 March 2000	1,020	4,800	840
1 April 2000 - 31 March 2001	1,200	5,040	900

Fiona's total cash takings for the year to 31 May 2000 were £31,680. Fiona banked her cash takings after the payment of certain weekly expenses which she estimated to be: general expenses £15; shop assistant £180. Fiona has a uniform pricing policy, being flowers at cost plus 100%. Fiona has withdrawn cash from the business for her own personal use but is unsure of the exact amount.

At the end of the year Fiona was rather disappointed to see that a similar van was for sale in a motor magazine for £9,000. A small amount of flowers are held in the shop and a float of £50 is maintained in the cash till. The shop is open all year round.

- **Requirement for question 1**

(a) Prepare the trading and profit and loss account for the year ended 31 May 2000. *14*

(b) Prepare the balance sheet as at 31 May 2000. *11*

(c) Draft a note to Fiona commenting on her first years' trading. *5*

(30)

2 The following ledger balances relate to the business of Gerry the Greengrocer as at 1 January 1999.

	£
Buildings	50,000
Stock	13,610
Creditors	12,000
Bank overdraft	685
Capital	52,000
Buildings depreciation	5,000
Cash	195
Debtors	9,305
Equipment	4,400
Electricity accrued	540
Loan	6,000
Vehicle depreciation	2,260
Equipment depreciation	1,320
Vehicle	9,040
Business rates prepaid	400
Retained profit	7,145

The following transactions took place during the financial year ended 31 December 1999.

	£
Credit sales	36,825
Cash sales	12,275
Returns inwards	1,100
Discounts allowed	735
Cheque paid for business rates	4,000
Cheque paid for electricity	1,660
Cash purchases	6,740
Cheques paid for salaries and wages	4,620
Discounts received	450
Credit purchases	20,215
Cash sale of all equipment	3,000
Cheque paid for loan repayment	1,000
Cash paid for new vehicle	7,000
Cheques paid for credit purchases	19,500
Cheques paid for miscellaneous expenses	7,400
Returns outwards	850
Cheques received from credit sales	40,000

Gerry operates debtor and creditor control accounts.

In the past Gerry has depreciated his fixed assets using the accounting policies below:

	%	**Method**
Buildings	2	Straight line
Equipment	30	Straight line
Vehicles	25	Reducing balance

Gerry charges a full year's depreciation in the year in which the fixed asset acquisition took place and none in the year of disposal.

Gerry established the following closing balances as at 31 December 1999:

	£
Business rates paid in advance	200
Electricity owing	340
Stock in hand	11,200

- **Requirement for question 2**

Produce all relevant ledger accounts for the financial year ended 31 December 1999 which record opening balances, transactions, and closing entries.

Trading and Profit and Loss ledger accounts are not required. *20*

3

Bob the Builder started trading on 1 May 1997. As accountant to Bob, you have adjusted his bad debt provision at the end of each year on a percentage basis to reflect the 'current economic climate' as follows:

Year ended	**Credit sales**	**Debtors at year end**	**Bad debts yet to be written off**	**Percentage provided for bad debts**
	£	**£**	**£**	**%**
30 April 1998	100,000	11,400	3,000	2
30 April 1999	108,000	15,950	3,750	3
30 April 2000	116,640	18,100	1,500	4

Bob is concerned that the percentage for bad debts is rising and would rather see it reduced to 2%. He has also just informed you that a debt written off in 1998/99 was recovered in February 2000. The amount received was £750.

- **Requirement for question 3**

(a) Explain the need to provide for bad debts. *3*

(b) Produce the various bad debt ledger accounts for each of the three years. *8*

(c) Produce the balance sheet extracts for each of the three years. *3*

(d) Draft a note to Bob which comments on the percentage provision and the debtors collection period and makes recommendations for any action to be taken. *6*

(20)

4

Mel and Godfrey operate as 'Potters Independent Trading'.

On 1 April 2000 they purchased 200 pairs of jeans for £4,000. By 5 April 2000, 150 pairs had been sold for £4,500. On 6 April 2000 another 80 pairs were purchased at a cost of £2,000. The following day 40 pairs were sold for £1,200. Mel and Godfrey are in the habit of selling older stock first.

On 12 April 2000 they acquired 100 T-shirts for £500 but had not paid for them. All but 30 were sold the next day for £15 each. However, the remainder were damaged and Mel expects to get £2 per T-shirt.

On 15 April 2000 Godfrey managed to obtain 50 video recorders for £2,500 as there seemed to be something wrong with them. Godfrey is of the opinion that he could repair them at a cost of £10 each and sell them at £80, making a good profit.

On 20 April 2000 Mel made a deal with Trigger. Trigger supplied 25 cases of wine on a sale or return basis. By the end of the month Mel had sold 20 cases for £20 each, for which Trigger was charging £12 per case.

- **Requirement for question 4**

(a) Explain what is meant by 'lower of cost and net realisable value' in valuing stock. *2*

(b) Produce a trading account for each stock type for the month of April 2000. *8*

(c) Explain three possible methods of pricing out stocks using 'Potters Independent Trading' to illustrate. *5*

(15)

SECTION B (Answer ONE question)

5 Padro plc is a company in the china industry. Annually, Padro plc spends significantly on research and development into new products. The company's policy for capitalised development costs is to amortise them over five years on a straight line basis.

The following expenditure was incurred during the year ended 31 December 1999:

	£000
Research expenditure	2,000
Development expenditure	
• Project Y - was abandoned during 1999 due to a technical problem.	500
• Project Z - meets all the criteria for capitalisation with likely sales taking place in 2001.	400

Project X was completed at the end of 1997 at a total cost of £1,000,000 and is being amortised in line with company policy.

- **Requirement for question 5**

(a) Explain the three ways in which research and development costs may be classified as stated in SSAP 13 Research and Development. *3*

(b) State the conditions which must be met for research and development costs to be capitalised. *6*

(c) Determine the amounts for research and development to be included in the financial statements of Padro plc for the year ending 31 December 1999. *6*

(15)

6

SSAP 2 identifies four fundamental accounting concepts. However, other accounting concepts do exist.

- **Requirement for question 6**

(a) What is meant by an accounting concept? *2*

(b) Other than the four identified in SSAP 2, identify and explain **six** other accounting concepts that are only generally reinforced through custom and practice. *13*

(15)